NASAA

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October 10, 2017

The Honorable Jeb Hensarling	The Honorable Maxine Waters
Chairman	Ranking Member
House Committee on Financial Services	House Committee on Financial Services
Washington, DC 20515	Washington, DC 20515

Re: October 11, 2017 Full Committee Markup

Dear Chairman Hensarling and Ranking Member Waters:

On behalf of the North American Securities Administrators Association ("NASAA"),[1] I am writing to express NASAA's views on legislation that the House Financial Services Committee will consider during this week's markup. Included are measures that NASAA supports, such as H.R. 3758, the Senior Safe Act of 2017, and H.R. 477, the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2017. NASAA is concerned, however, that several measures before the Committee have the potential to harm investors. These bills include H.R. 3857, the Protecting Advice for Small Savers Act; H.R. 2201, the Micro Offering Safe Harbor Act; and an Amendment in the Nature of a Substitute to H.R. 1585, the Fair Investment Opportunities for Professional Experts Act.

NASAA has previously addressed other bills that may be considered by the Committee this week, including in testimony delivered on the Financial CHOICE Act on April 28, 2017,[2] and in previous comment letters. While my letter does not reiterate NASAA's views on these bills, all relevant testimony and comment letters remain publicly available on NASAA's website.[3]

The Protecting Advice for Small Savers Act (H.R. 3857)

The Protecting Advice for Small Savers Act would amend the Securities Exchange Act of 1934 to establish a new "best interest" standard of care for broker-dealers and their agents when advising investors in the retail market.

As NASAA has previously testified to this Committee, state securities regulators strongly support the establishment of a fiduciary duty standard governing the conduct of broker-dealers and their agents (or "brokers") – in the retail context and the retirement context – to match the currently

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[1] The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[2] Written Testimony of Maryland Securities Commissioner Melanie Senter Lubin submitted for House Financial Services Committee hearing entitled "A Legislative Proposal to Create Hope and Opportunity for Investors, Consumers, and Entrepreneurs." April 28, 2017. Washington, D.C. Accessible at: NASAA.org/41990/legislative-proposal-create-hope-opportunity-investors-consumers-entrepreneurs-2/.

[3] NASAA.org.

existing standard applied to investment advisers.[4] With Americans living longer and, in many instances, facing underfunded retirements, it is essential that the assets they do have are safeguarded by fiduciary obligations when placed in trust with their financial advisors, including brokers. The establishment of a fiduciary standard for brokers would not only guarantee that financial professionals providing personalized investment advice will act in the best interests of their clients, but create a more level playing field, and help eliminate confusion about the different duties of care that brokers and investment advisers owe their clients. The fiduciary standard – the highest legal standard of a professional – is what Main Street investors should and do expect from their financial and investment professionals.

Unfortunately, H.R. 3857 would not impose a standard whereby a broker is required to put the interests of their clients ahead of their own. Rather the bill relies on a series of disclosures that fall well short of imposing meaningful duties of care and loyalty. This approach, while a marginal improvement on the current "suitability" regime, nevertheless falls short of the duties that now exist for investment advisers, and for professionals in various fields, including trustees and lawyers.[5] The new "best interest" standard of care proposed in H.R. 3857 could also force various federal courts to reinterpret the law in ways that are unpredictable, and may result in greater potential liability for market and industry participants. Thus, while the bill would arguably provide enhanced protections for investors in the retail context, at least relative to the current "suitability" standard, any benefit that might be realized from such changes would likely be more than offset by the fact that the bill simultaneously repeals the DOL rule's fiduciary protections for retirement investors.[6]

Further, Section 3(a)6 of H.R. 3857 includes deeply problematic provisions directing that the duty of care established under the bill shall "supersede and preempt State law." The precise scope of the contemplated preemption is somewhat vague, but the apparent intent is to preempt state laws that impose more stringent or additional duties of care on broker-dealers than the "standard of conduct for the provision of financial services to retail customers" established by Section 3(a)1 of the legislation.[7] The significance of this provision's enactment would be to wipe away well-established fiduciary protections that are currently the product of case law in a number of states, including as they relate to advice provided in the retail context, and forestall any future initiative by state legislatures to impose standards of conduct on broker-dealers under state law.

In conclusion, the policy changes contemplated by H.R. 3857 are on balance a bad deal for America's investors. While NASAA continues to advocate for a heightened duty of care for broker-dealers for advice provided in the retail context, the protections that may be afforded by state securities laws, and by the DOL's fiduciary rule for retirement accounts, are among the most consequential afforded to U.S. investors. Accordingly, NASAA urges the Committee to reject H.R. 3857, and to refrain from approving any legislation that would limit the ability of states or the SEC to undertake

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[4] NASAA has a long advocated a fiduciary duty for broker-dealers, including consistent with Section 913 of the Dodd-Frank Act. See: Letter from William Beatty, NASAA President and Wash. Sec. Adm'r, to Brent J. Fields, Secretary, U.S. Sec. and Exch. Comm. (July 21, 2015); Letter from A. Heath Abshure, NASAA President and Ark. Sec. Adm'r, to Elizabeth M. Murphy, Secretary, U.S. Sec. and Exch. Comm. (July 5, 2013).

[5] Suitability is established for broker-dealers, pursuant to rules of the Financial Industry Regulatory Authority ("FINRA"); by codifying central elements of the suitability framework as a new federal "best interest" standard that would be applicable to brokers providing personalized investment advice in the retirement and retail context, H.R. 3857 implies that all conflicts could be cured through disclosure. While it is certainly appropriate to cure certain conflicts through disclosure, certain conflicts should be outright prohibited, and in all financial relationships, the "highest" duty of care should be applied.

[6] Currently, the DOL's stronger standard of care applies nationally to broker-dealers in the provision of retirement advice.

[7] The preemption established by Section 3(a)6 would not apply to insurance products.

additional steps to further enhance protections for investors receiving advice from brokers in the retail context, and instead embrace the well-established fiduciary standard.

The Senior Safe Act (H.R. 3758)

The Senior Safe Act will better protect persons aged 65 and older from financial exploitation by increasing the likelihood it will be identified by financial services professionals, and by removing barriers to reporting this abuse, so that state regulators and other appropriate authorities can help stop it. The legislation consists of several essential features. First, to promote and encourage reporting of suspected elderly financial exploitation by financial services professionals, who are positioned to identify and report "red flags" of potential exploitation, the bill would incentivize financial services employees to report any suspected exploitation by providing qualified immunity from civil or administrative liability arising from such a report, provided that they exercised due care, and that they make these reports in good faith. Second, in order to better assure that financial services employees have the knowledge and training they require to identify "red flags" associated with financial exploitation, the bill would require that, as a precondition of receiving immunity, financial institutions undertake to train certain personnel regarding the identification and reporting of senior financial exploitation.

The Senior Safe Act's objectives and benefits are far-reaching. Older Americans stand to benefit directly from such reporting, because early detection and reporting will minimize their financial losses from exploitation, and because improved protection of their finances ultimately helps preserve their financial independence and their personal autonomy. Financial institutions stand to benefit, as well, through preservation of their reputation, increased community recognition, increased employee and customer satisfaction, and decreased potential losses.

State securities regulators strongly support the Senior Safe Act, as we have since its introduction in 2015. We urge the Committee to favorably report H.R. 3758.

The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act (H.R. 477)

The Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act would establish an exemption from registration requirements under federal securities laws for persons serving as brokers in certain merger and acquisition deals ("M&A brokers"). State securities regulators share Congress's interest in establishing a more streamlined regulatory framework for persons serving as brokers in M&A deals that involve the transfer of securities, subject to certain conditions. These conditions include the following:(1) the disqualification from the exemption of any broker or associated person who is a "bad actor," or subject to suspension or revocation of registration; and (2) the inapplicability of the exemption to any M&A transaction where one party or more is a shell company.

NASAA supported legislation identical to H.R. 477 when it was passed by the House as a provision of a broader legislative package in 2016, and continues to support the legislation. We also note the federal exemption that would be established by the legislation closely mirrors an existing

NASAA Model Rule which exempts M&A brokers from state securities registration pursuant to certain conditions.[8] We urge the Committee to favorably report H.R. 477.

The Micro Offering Safe Harbor Act (H.R. 2201)

The Micro-Offering Safe Harbor Act proposes to amend Section 4 of the Securities Act to create a new exemption from registration for an offering that meets certain criteria regarding the number of purchasers, their relationship to the issuers, and the amount of capital raised. The bill also preempts state regulation of these proposed securities offerings, and does not prohibit general solicitation, disqualify bad-actors, limit offering amounts (for instance, to unaccredited investors), or permit any notice filings to state and federal regulators.[9]

As NASAA has previously testified, H.R. 2201 would result in an overly broad federal exemption that would allow public solicitation and sales to any investor regardless of sophistication or financial wherewithal, subject only to the requirement that there be a previously existing relationship—a standard that is not difficult to establish.[10] In practical terms, this means that Main Street investors could be solicited and sold up to $500,000 in private securities by "bad actors," including persons having been convicted of crimes or subject to one or more previous state enforcement actions, without any disclosure to the investor, and without any notice to state or federal regulators. Further, the practical necessity of the proposed exemption remains unclear—just as basic questions about what issuers it would serve remain unanswered.[11]

In addition to serving as "cops on the beat," state securities regulators serve as the primary regulators of many small and local securities offerings. As such, state securities regulators regularly work with and assist local businesses seeking investment capital. Moreover, state securities regulators, acting within NASAA, have a long history of working closely with the SEC to effect greater uniformity in federal-state securities matters.

There is no valid basis for Congress to prevent state officials charged with protecting their constituents from making decisions about the purely local or regional issuers that would rely on the exemption established by H.R. 2201. Further, preemption of state review, or even notification, for the type of small and localized offerings contemplated H.R. 2201 would effectively handcuff the regulators best positioned to oversee such offerings. NASAA urges the Committee to reject H.R. 2201.

Amendment in the Nature of a Substitute to the Fair Investment Opportunities for Professional Experts Act (H.R. 1585)

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[8] On September 29, 2016, NASAA adopted a Model Rule Exempting Certain Merger & Acquisition Brokers from Registration. The NASAA Model Rule is available at NASAA.cdn.s3.amazonaws.com/wpcontent/uploads/2011/07/MA-Broker-ModelRule-adopted-Sept.-29-2015.pdf.

[9] The exemption established by H.R. 2201 would be subject to the following three criteria: (1) each purchaser has a substantive pre-existing relationship with an officer or director of the issuer, or with a shareholder holding 10 percent or more of the issuer's shares; (2) there are no more than 35 purchasers of securities from the issuer in reliance on this exemption during the preceding 12 months; and (3) the aggregate amount raised by the issuer during the 12-month period preceding the transaction, including in reliance on this exemption, does not exceed $500,000.

[10] NASAA questions why an issuer would need to engage in public solicitation if it had a previously existing relationship.

[11] There are already various provisions at the state and federal level that small, microcap issuers can rely upon for limited offerings. For example, an issuer can raise funds under Rule 504, Section 3(a)(11) of the Securities Act of 1933 and its safe harbor Rule 147, and Section 4(a)(2) of the 1933 Act. Further, most states also have de minimus offering exemptions, allowing issuers to raise money with a limited number of purchasers through self-executing exemptions with little or no notice filing requirements. Finally, small issuers can similarly rely on federal crowdfunding rules and Regulation A.

NASAA has previously expressed concern with certain provisions in the Fair Investment Opportunities for Professional Experts Act, which is intended to effect a broad expansion of the number of persons qualifying as "accredited investors."[12] We appreciate the improvements embodied by the Amendment in the Nature of a Substitute ("ANS") offered by Congressman Hill; however, we believe the legislation can and should be further improved prior to passing the House. Specifically, NASAA urges Congress to go beyond merely indexing the income and net-worth tests for inflation on a going-forward basis, and to instead effectuate a meaningful increases or other improvements to these standards. The bill's proposal to codify the net-worth standard at the present $1 million level, even if indexed prospectively for inflation, is particularly worrisome given that many persons who qualify as "accredited" solely by virtue of their net worth are retirees who are not in a position to recoup or easily sustain potential losses associated with an investment in a private offering. Further, NASAA urges Congress to amend Section 2(a)(2)(D) of the bill to clarify that the designation of "any natural person…licensed or registered as broker" as an "accredited investor" would apply only to broker-dealer representatives having passed the FINRA Series 7 General Securities Representative Qualification Examination, or an equivalent successor examination, and not to "limited representatives" having passed only a less rigorous examination, such as the FINRA Series 6 Examination.

Thank you for your consideration of NASAA's views. Please do not hesitate to contact me, or Michael Canning, NASAA Director of Policy & Government Affairs, at (202) 737-0900, if we may be of any additional assistance.

Sincerely,

Joseph P. Borg
NASAA President and Alabama Securities Director

[12] See: Letter from NASAA President Judith M. Shaw regarding House Financial Services Committee markup of H.R. 2187, The Fair Investment Opportunities for Professional Experts Act of 2015. December 8, 2015. Accessible at: nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2013/10/Final-12.8.15-Letter-to-HFSC-Chair-and-RM-Re-12-8-15-Markup.pdf.